



BERBERICH TRAHAN & CO., P.A.

Certified Public Accountants

RURAL WATER DISTRICT NO. 3 OSAGE COUNTY, KANSAS

BASIC FINANCIAL STATEMENTS
WITH SUPPLEMENTARY INFORMATION
YEARS ENDED DECEMBER 31, 2008 and 2007

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

BASIC FINANCIAL STATEMENTS
WITH SUPPLEMENTARY INFORMATION

Years Ended December 31, 2008 and 2007

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BERBERICH TRAHAN & CO., P.A.
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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Rural Water District No. 3
Osage County, Kansas:

We have audited the accompanying basic financial statements of the business-type activities of Rural Water District No. 3, Osage County, Kansas (the District) as of and for the years ended December 31, 2008 and 2007 as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the applicable provisions of the *Kansas Municipal Audit Guide*. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the District as of December 31, 2008 and 2007, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 3, 2009 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The District has not presented the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to supplement, although not to be part of, the basic financial statements.

Berberich Trahan & Co., P.A.

June 3, 2009

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RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

STATEMENTS OF NET ASSETS

December 31, 2008 and 2007

	2008	2007
Assets:		
Current assets:		
Cash and cash equivalents	\$ 80,608	\$ 119,476
Accounts receivable	27,986	27,172
Interest receivable	4,013	5,060
Prepaid expenses	9,677	5,879
Short-term investments	175,381	46,980
Total current assets	297,665	204,567
Noncurrent assets:		
Restricted investments:		
Revenue bond covenant accounts	62,000	65,500
Long-term investments	173,416	285,530
Note receivable	2,634	3,211
Capital assets not being depreciated	10,556	10,556
Capital assets being depreciated, net:		
Meters and distribution lines	200,775	175,081
Buildings	1,231,523	1,270,044
Office and plant equipment	8,014	9,968
Other	23,000	23,000
Total noncurrent assets	1,711,918	1,842,890
Total assets	2,009,583	2,047,457
Liabilities:		
Current liabilities:		
Current maturities of long-term debt	61,184	45,760
Accrued payroll taxes	102	172
Accrued payroll	4,308	4,308
Accrued interest	14,983	14,983
Other accrued expense	638	1,633
Total current liabilities	81,215	66,856
Long-term debt, less current maturities	753,785	814,969
Total liabilities	835,000	881,825
Net assets:		
Invested in capital assets, net of related debt	658,899	627,920
Restricted for debt service	62,000	65,500
Unrestricted	453,684	472,212
Total net assets	\$ 1,174,583	\$ 1,165,632

See accompanying notes to financial statements.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

STATEMENTS OF REVENUES, EXPENSES AND CHANGE IN NET ASSETS

Years Ended December 31, 2008 and 2007

	2008	2007
Operating revenues:		
Water sales	\$ 163,760	\$ 146,045
Service charges	94,118	94,160
Late charge fees	10,975	10,673
Miscellaneous	3,822	87
Total operating revenues	<u>272,675</u>	<u>250,965</u>
Operating expenses:		
Water treatment	25,382	22,787
Depreciation and amortization	64,777	68,295
Wages	65,660	60,957
Payroll taxes	5,227	4,868
Employee pension and benefits	1,811	3,736
Repairs	26,345	4,894
Engineering	508	-
Mapping costs	7,002	-
Annual water costs	8,607	-
Insurance	9,353	9,486
Utilities	13,250	12,184
Vehicle expense	2,925	2,375
Office expense	1,100	1,350
Postage	2,802	2,994
Dues and subscriptions	337	582
Telephone	1,794	1,623
Training	955	1,117
Software	1,000	1,000
Legal	8,812	9,496
Accounting	6,325	6,348
Miscellaneous	2,444	1,086
Total operating expenses	<u>256,416</u>	<u>215,178</u>
Operating income	<u>16,259</u>	<u>35,787</u>
Nonoperating revenue (expense):		
Interest income	18,748	26,271
Interest expense	(37,081)	(38,634)
Total nonoperating revenue (expense)	<u>(18,333)</u>	<u>(12,363)</u>
Income (loss) before capital contributions	<u>(2,074)</u>	<u>23,424</u>
Capital contributions:		
Benefit units sold	11,025	7,890
Patron contributions	-	1,214
Total capital contributions	<u>11,025</u>	<u>9,104</u>
Change in net assets	8,951	32,528
Net assets, beginning of year	1,165,632	1,133,104
Net assets, end of year	<u>\$ 1,174,583</u>	<u>\$ 1,165,632</u>

See accompanying notes to financial statements.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

STATEMENTS OF CASH FLOWS

Years Ended December 31, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Cash receipts from customers	\$ 271,861	\$ 248,554
Cash payments for goods and services	(123,734)	(77,274)
Cash payments to employees for services	(72,768)	(69,561)
Net cash provided by operating activities	75,359	101,719
Cash flows from investing activities:		
Purchases of investments	(12,787)	(20,619)
Interest income	19,795	29,007
Collections on note receivable	577	297
Net cash provided by investing activities	7,585	8,685
Cash flows from capital and related financing activities:		
Purchases of capital assets	(49,996)	(2,000)
Principal payments on long-term debt	(45,760)	(43,716)
Benefit units sold	11,025	7,890
Patron contributions	-	1,214
Interest expense	(37,081)	(38,634)
Net cash used in capital and related financing activities	(121,812)	(75,246)
Net increase (decrease) in cash and cash equivalents	(38,868)	35,158
Cash and cash equivalents, beginning of year	119,476	84,318
Cash and cash equivalents, end of year	\$ 80,608	\$ 119,476
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 16,259	\$ 35,787
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	64,777	68,295
Changes in assets and liabilities:		
Accounts receivable	(814)	(2,411)
Prepaid expenses	(3,798)	(1,415)
Accrued payroll tax	(70)	-
Other accrued expenses	(995)	1,463
Net cash provided by operating activities	\$ 75,359	\$ 101,719

See accompanying notes to financial statements.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

NOTES TO BASIC FINANCIAL STATEMENTS

December 31, 2008 and 2007

1 - Organization and Summary of Significant Accounting Policies

Reporting Entity

Rural Water District No. 3, Osage County, Kansas (the District) was organized under Kansas law and is accounted for as an enterprise fund using the accrual basis of accounting. The District's purpose and objective is to acquire water and water rights, to build and acquire pipe lines and other facilities, and to operate the same for the purpose of furnishing water for domestic, agriculture, and/or other purposes. The District provides service to patrons in Osage County.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

For financial reporting purposes, the District is considered a proprietary entity engaged only in business-type activities. The basic financial statements of the District have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Basis of accounting refers to when revenues, expenses and the related assets and liabilities are recognized in the accounts and reported in the financial statements. Measurement focus refers to what is being measured. The financial statements are prepared on the accrual basis of accounting and on an economic resources measurement focus in accordance with accounting principles generally accepted in the United States of America. With this measurement focus, all assets and liabilities are included on the statements of net assets. The statements of revenues, expenses and change in net assets present increases (revenues) and decreases (expenses) in net total assets. The statements of cash flows provide information about how the District meets the cash flow needs of its activities.

The District distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing goods and services in connection with ongoing operations. The principal operating revenues of the District are charges to customers for sales and services. Operating expenses include the costs of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

NOTES TO BASIC FINANCIAL STATEMENTS
(Continued)

1 - Organization and Summary of Significant Accounting Policies (Continued)

Measurement Focus, Basis of Accounting and Financial Statement Presentation (Continued)

Under GASB Statement No. 20, *Accounting and Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, all proprietary funds continue to follow Financial Accounting Standards Board (FASB) standards issued on or before November 30, 1989. However, from that date forward, proprietary funds have the option of either choosing not to apply future FASB standards (including amendments of earlier pronouncements), or continuing to follow new FASB pronouncements (unless they conflict with GASB guidance). The District has chosen not to apply future FASB standards for proprietary funds.

Statement of Cash Flows

For purposes of the statements of cash flows, the District considers all highly liquid investment instruments purchased with an original maturity of three months or less to be cash equivalents.

Investments

Investments represent nonnegotiable certificates of deposit. The certificates of deposit are recorded at cost because they are not affected by market rate changes.

Restricted Investments

Restricted investments represent amounts set aside for the repayment of the Water System Refunding Revenue Bonds, Series A, 2005.

Accounts Receivable

Accounts receivable are carried at original invoice amount less any estimate made for doubtful receivables based on a review of all outstanding amounts. The District reads meters the first day of each month or the earliest day thereafter. Payments for water service are due by the 25th day of the month or will be subject to a 10% late charge. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts.

Management is of the opinion that no allowance for doubtful accounts is necessary.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

NOTES TO BASIC FINANCIAL STATEMENTS
(Continued)

1 - Organization and Summary of Significant Accounting Policies (Continued)

Capital Assets

Capital assets, which include land, meters and distribution lines, buildings, and equipment, are shown at cost. Depreciation is computed using the straight-line method. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred; significant renewals and betterments are capitalized based on management's judgment. The District has a policy of capitalizing capital assets with a cost greater than \$ 5,000. A deduction is made for retirements resulting from renewals or betterments.

Capital Contributions

The sales price of benefit unit certificates is considered a contribution to the District. Contributions by developers or patrons for extensions are recorded as patron contributions. Both of these capital contributions are shown on the statement of revenues, expenses and change in net assets.

Net Assets

The District's net assets are classified as follows:

Investment in capital assets, net of related debt – This represents the District's total investment in capital assets, net of accumulated depreciation and related debt.

Restricted for debt service – This represents resources set aside in a bond reserve account in accordance with the bond covenant.

Unrestricted net assets – This includes resources derived from sales and services. These resources are used for transactions relating to providing sales and services and general operations of the District and may be used at the discretion of the governing board to meet current expenses for any purpose.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

NOTES TO BASIC FINANCIAL STATEMENTS
(Continued)

1 - Organization and Summary of Significant Accounting Policies (Continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2 - Deposits and Investments

At December 31, 2008 and 2007 and throughout the years ended December 31, 2008 and 2007, the District's investments included certificates of deposit. As of December 31, 2008, the District had the following investments and related maturities:

Investment Type	Carrying Value	Investments Maturities (in Years)			
		Less than 1	1 - 5	6 - 10	More Than 10
Certificates of deposit	\$ 410,797	\$ 175,381	\$ 235,416	\$ -	\$ -

As of December 31, 2007, the District had the following investments and related maturities:

Investment Type	Carrying Value	Investments Maturities (in Years)			
		Less than 1	1 - 5	6 - 10	More Than 10
Certificates of deposit	\$ 398,010	\$ 46,980	\$ 351,030	\$ -	\$ -

Credit Risk. Kansas statutes authorize the District, with certain restrictions, to deposit or invest in temporary notes, no-fund warrants, open accounts, time deposits, certificates of deposit, repurchase agreements, U.S. Treasury Bills and Notes, the State of Kansas Municipal Investment Pool or to make direct investments. Statutes also require the collateral pledged to have a fair market value equal to 100 percent of the deposits and investments, less insured amounts, and to be assigned for the benefit of the District.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

NOTES TO BASIC FINANCIAL STATEMENTS
(Continued)

2 - Deposits and Investments (Continued)

Custodial Credit Risk - Deposits. In the case of deposits, this is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a formal policy that addresses custodial credit risk. At December 31, 2008 and 2007, the District's deposits were not exposed to custodial credit risk.

Total deposits and investments of the District are shown in the financial statements as follows at December 31:

	<u>2008</u>	<u>2007</u>
Cash and cash equivalents	\$ 80,608	\$ 119,476
Short-term investments	175,381	46,980
Restricted investments:		
Revenue bond covenant accounts	62,000	65,500
Long-term investments	<u>173,416</u>	<u>285,530</u>
	<u>\$ 491,405</u>	<u>\$ 517,486</u>

3 - Note Receivable

In 1994, the District received a note from Lamont Hill Resort, Inc. to pay the District for providing water to its golf course. The original note balance was \$ 4,705. The term of the note is 35 years with principal and interest paid annually in the amount of \$ 372. The note bears interest at a rate of 7.21%. At December 31, 2008 and 2007, the note carried a balance of \$ 2,634 and \$ 3,211, respectively.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

NOTES TO BASIC FINANCIAL STATEMENTS
(Continued)

4 - Capital Assets

Following is a summary of changes in capital assets for the years ended December 31, 2008 and 2007:

Fiscal year 2008:

	Balance December 31, 2007	Additions	Retirements	Balance December 31, 2008	Estimated Useful Lives
Capital assets not being depreciated:					
Land	\$ 10,556	\$ -	\$ -	\$ 10,556	N/A
Total capital assets not being depreciated	10,556	-	-	10,556	
Capital assets being depreciated:					
Meters & distribution lines	456,110	49,996	-	506,106	10-40 years
Buildings	1,904,872	-	-	1,904,872	15-50 years
Office equipment	9,529	-	-	9,529	3-10 years
Plant equipment	36,778	-	-	36,778	10-15 years
Total capital assets being depreciated	2,407,289	49,996	-	2,457,285	
Less accumulated depreciation for:					
Meters & distribution lines	(281,029)	(24,302)	-	(305,331)	
Buildings	(634,828)	(38,521)	-	(673,349)	
Office equipment	(9,367)	(109)	-	(9,476)	
Plant equipment	(26,972)	(1,845)	-	(28,817)	
Total accumulated depreciation	(952,196)	(64,777)	-	(1,016,973)	
Total capital assets being depreciated, net	1,455,093	(14,781)	-	1,440,312	
	<u>\$ 1,465,649</u>	<u>\$ (14,781)</u>	<u>\$ -</u>	<u>\$ 1,450,868</u>	

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

NOTES TO BASIC FINANCIAL STATEMENTS
(Continued)

4 - Capital Assets (Continued)

Fiscal year 2007:

	Balance December 31, 2006	Additions	Retirements	Balance December 31, 2007	Estimated Useful Lives
Capital assets not being depreciated:					
Land	\$ 10,556	\$ -	\$ -	\$ 10,556	N/A
Total capital assets not being depreciated	10,556	-	-	10,556	
Capital assets being depreciated:					
Meters & distribution lines	456,110	-	-	456,110	10-40 years
Buildings	1,904,872	-	-	1,904,872	15-50 years
Office equipment	9,529	-	-	9,529	3-10 years
Plant equipment	34,778	2,000	-	36,778	10-15 years
Total capital assets being depreciated	2,405,289	2,000	-	2,407,289	
Less accumulated depreciation for:					
Meters & distribution lines	(257,227)	(23,802)	-	(281,029)	
Buildings	(596,306)	(38,522)	-	(634,828)	
Office equipment	(9,037)	(330)	-	(9,367)	
Plant equipment	(24,902)	(2,070)	-	(26,972)	
Total accumulated depreciation	(887,472)	(64,724)	-	(952,196)	
Total capital assets being depreciated, net	1,517,817	(62,724)	-	1,455,093	
	<u>\$ 1,528,373</u>	<u>\$ (62,724)</u>	<u>\$ -</u>	<u>\$ 1,465,649</u>	

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

NOTES TO BASIC FINANCIAL STATEMENTS
(Continued)

5 - Long-Term Debt

Following is a summary of changes in long-term debt for the years ended December 31, 2008 and 2007:

Fiscal year 2008:

	Beginning Principal Outstanding	Additions to Principal	Reductions of Principal	Refunding of Principal	Ending Principal Outstanding	Amount Due in One Year
Series A 2005 revenue bonds	\$ 655,000	\$ -	\$ 35,000	\$ -	\$ 620,000	\$ 50,000
KDHE loan	224,385	-	10,760	-	213,625	11,184
	<u>\$ 879,385</u>	<u>\$ -</u>	<u>\$ 45,760</u>	<u>\$ -</u>	833,625	<u>\$ 61,184</u>
Less deferred charge on refunding					18,656	
					814,969	
Less current maturities					61,184	
					<u>\$ 753,785</u>	

Fiscal year 2007:

	Beginning Principal Outstanding	Additions to Principal	Reductions of Principal	Refunding of Principal	Ending Principal Outstanding	Amount Due in One Year
Series A 2005 revenue bonds	\$ 690,000	\$ -	\$ 35,000	\$ -	\$ 655,000	\$ 35,000
KDHE loan	233,101	-	8,716	-	224,385	10,760
	<u>\$ 923,101</u>	<u>\$ -</u>	<u>\$ 43,716</u>	<u>\$ -</u>	879,385	<u>\$ 45,760</u>
Less deferred charge on refunding					18,656	
					860,729	
Less current maturities					45,760	
					<u>\$ 814,969</u>	

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

NOTES TO BASIC FINANCIAL STATEMENTS
(Continued)

5 - Long-Term Debt (Continued)

In August 2005, the District issued \$ 725,000 of Kansas Rural Water Finance Authority Refunding Revenue Bonds, Series A, 2005 to refund the Kansas Rural Water Finance Authority Revenue Bonds, Series B, 1999 of the District. The refunding was undertaken to take advantage of lower interest rates and to reduce total future debt service payments. Net revenue produced from the District's system was pledged as collateral against the bonds. The Series 2005 bonds bear interest at rates ranging from 3.10% to 4.50%, include principal payments ranging from \$ 35,000 to \$ 70,000, and mature on September 1, 2019.

In 2005, the District entered into a loan agreement in the amount of \$ 500,000 with the Kansas Department of Health and Environment (KDHE) in order to fund the construction of a new water tower. KDHE withheld \$ 50,000 from the loan proceeds to establish a loan reserve to be applied against the loan in the final year of repayment. The KDHE loan, with semi-annual principal payments ranging from \$ 3,490 to \$ 10,474, bears an interest rate of 3.55% and matures on August 1, 2025.

Annual debt service requirements to maturity for the bonds are as follows:

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Due</u>
2009	\$ 50,000	\$ 26,210	\$ 76,210
2010	50,000	24,360	74,360
2011	55,000	22,410	77,410
2012	55,000	20,210	75,210
2013	55,000	17,955	72,955
2014-2018	285,000	54,460	339,460
2019-2023	70,000	3,150	73,150
	<u>\$ 620,000</u>	<u>\$ 168,755</u>	<u>\$ 788,755</u>

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

NOTES TO BASIC FINANCIAL STATEMENTS
(Continued)

5 - Long-Term Debt (Continued)

Annual debt service requirements to maturity for the KDHE loan are as follows:

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Due</u>
2009	\$ 11,184	\$ 9,260	\$ 20,444
2010	11,624	8,859	20,483
2011	12,082	8,443	20,525
2012	12,558	8,010	20,568
2013	13,052	7,560	20,612
2014-2018	73,389	30,400	103,789
2019-2023	79,736	17,991	97,727
	<u>\$ 213,625</u>	<u>\$ 90,523</u>	<u>\$ 304,148</u>

6 - Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; business interruptions; errors and omissions; employee injuries and illnesses; natural disaster; and employee accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than those related to employee workers' compensation claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years. There have not been significant reductions in coverage from prior years.



BERBERICH TRAHAN & CO., P.A.
Certified Public Accountants

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Board of Directors
Rural Water District No. 3
Osage County, Kansas:

We have audited the basic financial statements of the business-type activities of Rural Water District No. 3, Osage County, Kansas (the District) as of and for the year ended December 31, 2008, and have issued our report thereon dated June 3, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies, described in the accompanying schedule of findings and responses as Findings 2008-1 through 2008-5, to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the the significant deficiencies described above are not material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The District's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the District's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, others within the entity and management and is not intended to be and should not be used by anyone other than these specified parties.

Berberick Trehan & Co., P.A.

June 3, 2009

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

SCHEDULE OF FINDINGS AND RESPONSES

Year Ended December 31, 2008

Finding 2008-1 - Significant Deficiency (Repeated from Prior Year)

Condition – The payroll records, including timesheets for two of the four employees and wage rates, are not reviewed by someone other than the bookkeeper.

Cause – Due to small size of the District, there is a limited number of employees to perform financial duties.

Criteria – Review and approval of the payroll records is important for the District to prevent the possible occurrence of errors or fraud.

Effect – The lack of approval of payroll records could lead to other potential errors or fraud.

Recommendation – We recommend that procedures be implemented that would allow for the review of payroll records, including timesheets and wage rates, for each employee for each payroll cycle.

Management's Response/Corrective Action Plan (Unaudited) – The payroll records, including employee's time sheets, wages, etc. are now reviewed by the Board each month.

Finding 2008-2 - Significant Deficiency (Repeated from Prior Year)

Condition – It is the current procedure of the District that the person in charge of accounts receivable collects cash receipts, fills out the deposit slip, enters cash receipts into the accounts receivable ledger and reconciles the bank statement.

Cause – Due to small size of the District, there is a limited number of employees to perform financial duties.

Criteria – Segregating certain accounting duties is important for protection of both the District and the person performing multiple functions.

Effect – This combination of duties is incompatible for optimal internal control and increases the chance of an error or irregularity going undetected.

Recommendation – We recommend, at a minimum, segregating the collection of cash receipts and recording of cash receipts to protect the assets of the District.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

SCHEDULE OF FINDINGS AND RESPONSES
(Continued)

Management's Response/Corrective Action Plan (Unaudited) – The bookkeeper no longer receives cash at the office. All deposits go directly to the bank.

Finding 2008-3 - Significant Deficiency (Repeated from Prior Year)

Condition - The District does not have an accounting system procedure manual at the present time. Currently, the bookkeeper is the only employee with access and appropriate knowledge about the accounting system.

Cause – Due to the small size of the District, there is a limited number of employees to perform financial duties.

Criteria – Assessing potential risks and having contingency plans is critical to the ongoing operations of the District.

Effect – This lack of a contingency plan could lead to service delays and an inability to produce financial information in the absence of the bookkeeper.

Recommendation – We recommend the development of a formal accounting system procedures manual to document the accounting processes of the District. This manual should outline accounting processes, report formats, account codes and descriptions, and similar descriptive material to be followed by the District.

Management's Response/Corrective Action Plan (Unaudited) – An accounting system manual is an ongoing project. Since none of the Board is an accountant and the bookkeeper has had no formal accounting education, this is a rather slow process. The Board does not feel this adversely affects the integrity of the District's accounting functions.

Finding 2008-4 - Significant Deficiency (Repeated from Prior Year)

Condition – The District does not maintain a detailed listing of capital assets that includes the asset description, cost, accumulated depreciation and current location of each asset. The District has relied upon the auditor to update and maintain the listing.

Cause – The District has not implemented procedures that would allow for the District to identify and maintain records for capital assets.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

SCHEDULE OF FINDINGS AND RESPONSES
(Continued)

Criteria – Such a detailed listing is necessary to help insure adequate control over capital assets as well as to provide support for the financial statements.

Effect – The lack of maintaining a list of capital assets could lead to a misappropriation of the assets and misstatement of the capital assets.

Recommendation – We recommend that the District implement procedures that would require at least an annual physical inventory of all capital assets and the creation and maintenance of a detailed capital asset listing.

Management's Response/Corrective Action Plan (Unaudited) – This has been taken under advisement and work will be beginning.

Finding 2008-5 - Significant Deficiency (Repeated from Prior Year)

Condition – The financial statements are the responsibility of the District's management. During the course of the audit, we made four adjusting journal entries, primarily to adjust balance sheet accounts.

Cause – An overall lack of understanding of generally accepted accounting principles.

Criteria – The financial statements are the responsibility of management. As such, the District's internal control over the financial statements should identify misstatements on a consistent basis. Also, management should have the ability to prepare and/or evaluate the District's financial statements.

Effect – Ineffective controls over the period-end financial statements resulted in the inability of management to prepare and/or evaluate the District's financial statements.

Recommendation – We recommend that management implement procedures to reconcile all accounts at year-end and to prepare and/or evaluate the District's financial statements.

Management's Response/Corrective Action Plan (Unaudited) – The Board of Directors makes every effort to insure that the District operates as efficiently as possible. Given the size and financial means of the District, the Board undertakes the oversight of some of the District's own accounting procedures so as to avoid the necessity of incurring further overhead by hiring additional staff. Due to the Board's involvement, several accounting and reconciliation processes have fallen to the responsibility of the Board. It is the Board's position that under the circumstances it is most cost efficient to operate in this manner and do not believe that it adversely impacts the integrity of the District's accounting functions to do so.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS AND RESPONSES

Year Ended December 31, 2008

Finding 2007-1

Material Weakness – The payroll records, including timesheets and wage rates, are not reviewed by someone other than the bookkeeper.

Cause – Due to small size of the District, there is a limited number of employees to perform financial duties.

Criteria – Review and approval of the payroll records is important for the District to prevent the possible occurrence of errors or fraud.

Effect – As a result, in the current year, one employee was paid overtime in the wrong month, one employee was paid for less hours than was worked, and one employee was paid for a significantly increased number of hours with no specific reason available from District employees. The lack of approval of payroll records could lead to other potential errors or fraud.

Recommendation – We recommend that procedures be implemented that would allow for the review of payroll records, including timesheets and wage rates, for each payroll cycle.

Management's Response/Corrective Action Plan (Unaudited) – The Board of Directors makes every effort to insure that the District operates as efficiently as possible. Given the size and financial means of the District, the Board undertakes the oversight of some of the District's own accounting procedures so as to avoid the necessity of incurring further overhead by hiring additional staff. Due to the Board's involvement, several accounting and reconciliation processes have fallen to the responsibility of the Board. It is the Board's position that under the circumstances it is most cost efficient to operate in this manner and do not believe that it adversely impacts the integrity of the District's accounting functions to do so.

Follow-up – This comment is repeated in the current year and is shown as Finding 2008-1 in the schedule of findings and responses.

Finding 2007-2

Significant Deficiency – It is the current procedure of the District that the person in charge of accounts receivable collects cash receipts, fills out the deposit slip, enters cash receipts into the accounts receivable ledger and reconciles the bank statement.

Cause – Due to small size of the District, there is a limited number of employees to perform financial duties.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS AND RESPONSES
(Continued)

Criteria – Segregating certain accounting duties is important for protection of both the District and the person performing multiple functions.

Effect – This combination of duties is incompatible for optimal internal control and increases the chance of an error or irregularity going undetected.

Recommendation – We recommend, at a minimum, segregating the collection of cash receipts and recording of cash receipts to protect the assets of the District.

Management's Response/Corrective Action Plan (Unaudited) – The Board of Directors makes every effort to insure that the District operates as efficiently as possible. Given the size and financial means of the District, the Board undertakes the oversight of some of the District's own accounting procedures so as to avoid the necessity of incurring further overhead by hiring additional staff. Due to the Board's involvement, several accounting and reconciliation processes have fallen to the responsibility of the Board. It is the Board's position that under the circumstances it is most cost efficient to operate in this manner and do not believe that it adversely impacts the integrity of the District's accounting functions to do so.

Follow-up – This comment is repeated in the current year and is shown as Finding 2008-2 in the schedule of findings and responses.

Finding 2007-3

Significant Deficiency - The District does not have an accounting system procedure manual at the present time. Currently, the bookkeeper is the only employee with access and appropriate knowledge about the accounting system.

Cause – Due to the small size of the District, there is a limited number of employees to perform financial duties.

Criteria – Assessing potential risks and having contingency plans is critical to the ongoing operations of the District.

Effect – This lack of a contingency plan could lead to service delays and an inability to produce financial information in the absence of the bookkeeper.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS AND RESPONSES
(Continued)

Recommendation – We recommend the development of a formal accounting system procedures manual to document the accounting processes of the District. This manual should outline accounting processes, report formats, account codes and descriptions, and similar descriptive material to be followed by the District.

Management's Response/Corrective Action Plan (Unaudited) – The Board of Directors makes every effort to insure that the District operates as efficiently as possible. Given the size and financial means of the District, the Board undertakes the oversight of some of the District's own accounting procedures so as to avoid the necessity of incurring further overhead by hiring additional staff. Due to the Board's involvement, several accounting and reconciliation processes have fallen to the responsibility of the Board. It is the Board's position that under the circumstances it is most cost efficient to operate in this manner and do not believe that it adversely impacts the integrity of the District's accounting functions to do so.

Follow-up – This comment is repeated in the current year and is shown as Finding 2008-3 in the schedule of findings and responses.

Finding 2007-4

Significant Deficiency – The District does not maintain a detailed listing of capital assets that includes the asset description, cost, accumulated depreciation and current location of each asset. The District has relied upon the auditor to update and maintain the listing.

Cause – The District has not implemented procedures that would allow for the District to identify and maintain records for capital assets.

Criteria – Such a detailed listing is necessary to help insure adequate control over capital assets as well as to provide support for the financial statements.

Effect – The lack of maintaining a list of capital assets could lead to a misappropriation of the assets and misstatement of the capital assets.

Recommendation – We recommend that the District implement procedures that would require at least an annual physical inventory of all capital assets and the creation and maintenance of a detailed capital asset listing.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS AND RESPONSES
(Continued)

Management's Response/Corrective Action Plan (Unaudited) – The Board of Directors makes every effort to insure that the District operates as efficiently as possible. Given the size and financial means of the District, the Board undertakes the oversight of some of the District's own accounting procedures so as to avoid the necessity of incurring further overhead by hiring additional staff. Due to the Board's involvement, several accounting and reconciliation processes have fallen to the responsibility of the Board. It is the Board's position that under the circumstances it is most cost efficient to operate in this manner and do not believe that it adversely impacts the integrity of the District's accounting functions to do so.

Follow-up – This comment is repeated in the current year and is shown as Finding 2008-4 in the schedule of findings and responses.

Finding 2007-5

Significant Deficiency – The District does not maintain an inventory listing nor is there a physical inventory count performed at year-end.

Cause – The District has deemed inventory to be insignificant and relies on its employees to keep track of inventory.

Criteria – Such a detailed listing is necessary to help insure adequate control over inventory as well as to provide support for the financial statements.

Effect – The lack of maintaining an inventory listing could lead to a misappropriation of inventory.

Recommendation – We recommend that the District implement procedures that would require at least an annual physical inventory count and the creation and maintenance of a detailed inventory listing.

Management's Response/Corrective Action Plan (Unaudited) – The Board of Directors makes every effort to insure that the District operates as efficiently as possible. Given the size and financial means of the District, the Board undertakes the oversight of some of the District's own accounting procedures so as to avoid the necessity of incurring further overhead by hiring additional staff. Due to the Board's involvement, several accounting and reconciliation processes have fallen to the responsibility of the Board. It is the Board's position that under the circumstances it is most cost efficient to operate in this manner and do not believe that it adversely impacts the integrity of the District's accounting functions to do so.

Follow-up – This comment is no longer considered a significant deficiency and will not be repeated in the current year.

RURAL WATER DISTRICT NO. 3
OSAGE COUNTY, KANSAS

SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS AND RESPONSES
(Continued)

Finding 2007-6

Significant Deficiency – The financial statements are the responsibility of the District's management. During the course of the audit, we made three adjusting journal entries, primarily to adjust balance sheet accounts.

Cause – An overall lack of understanding of generally accepted accounting principles.

Criteria – The financial statements are the responsibility of management. As such, the District's internal control over the financial statements should identify misstatements on a consistent basis. Also, management should have the ability to prepare and/or evaluate the District's financial statements.

Effect – Ineffective controls over the period-end financial statements resulted in the inability of management to prepare and/or evaluate the District's financial statements.

Recommendation – We recommend that management implement procedures to reconcile all accounts at year-end and to prepare and/or evaluate the District's financial statements.

Management's Response/Corrective Action Plan (Unaudited) – The Board of Directors makes every effort to insure that the District operates as efficiently as possible. Given the size and financial means of the District, the Board undertakes the oversight of some of the District's own accounting procedures so as to avoid the necessity of incurring further overhead by hiring additional staff. Due to the Board's involvement, several accounting and reconciliation processes have fallen to the responsibility of the Board. It is the Board's position that under the circumstances it is most cost efficient to operate in this manner and do not believe that it adversely impacts the integrity of the District's accounting functions to do so.

Follow-up – This comment is repeated in the current year and is shown as Finding 2008-5 in the schedule of findings and responses.